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In the Supreme Court of the United States

October Term, 1955

No. 863

LIBSON SHOPS, INC., *Petitioner*

v.

GUSTAVE F. KOEHLER, District Director
Of Internal Revenue

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 36-46) is not officially reported. The opinion of the Court of Appeals (Pet. 13-29) is reported at 229 F. 2d 220.

JURISDICTION

The judgment of the Court of Appeals was entered January 19, 1956. (Pet. 13.) An order denying taxpayer's petition for rehearing was entered February 16, 1956. The petition for a writ of certiorari was filed April 14, 1956. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the taxpayer corporation is entitled, under Sections 23(s) and 122 of the Internal Revenue Code of 1939, to carry over and deduct from its own income for the taxable year here involved net operating losses sustained in prior years by other corporations which were merged into it.

STATUTE AND REGULATIONS INVOLVED

Sections 23(s) and 122(a), (b), and (c) of the Internal Revenue Code of 1939, and Section 29.122-1(a) and (b) of Treasury Regulations 111, are set forth in the Appendix, *infra*, pp. 12-15.

STATEMENT

The material facts as stipulated (R. 14-35) and found by the District Court (R. 36) may be summarized as follows:

The taxpayer is a Missouri corporation organized at the beginning of 1946 under the name of Libson Shops Management Corporation. (R. 16, 21.) It engaged in the business of providing

management services for sixteen Missouri and Illinois corporations, each of which operated a store selling women's apparel at retail. (R. 16.) All of the outstanding stock of each of the corporations was owned, directly or indirectly, by the same eight individuals and in the same proportions. (R. 17, 24.)

On August 1, 1949, pursuant to the laws of Missouri and Illinois, the sixteen separate operating corporations were merged into the taxpayer corporation (R. 16-17, 21-35), and taxpayer's stock was issued in exchange for the stock of the merged corporations (R. 17-18). Under the terms of the merger, the name of the taxpayer corporation was changed, the amount and par value of its stock were revised, and its business purposes were extended. (R. 21-34.) After the merger, taxpayer operated the stores which had formerly been operated separately by the sixteen merged corporations. (R. 19.)

Prior to the merger, three of the merged corporations had sustained net operating losses from their respective businesses. In the year following the merger (the taxable year here involved), each of the businesses formerly operated by these three corporations continued to sustain a net operating loss. (R. 19.)

In its income tax return for the first taxable year after the merger (the year ended July 31, 1950), taxpayer claimed as a deduction the total

($22,432.76) of the net operating losses sustained before the merger by the three corporations. (R. 18-19.) With the deduction, taxpayer reported a net income of $46,794.70.

The Commissioner disallowed the claimed deduction, and taxpayer paid the resulting tax deficiency. (R. 15.) Taxpayer duly filed a claim for refund, which was disallowed, and then instituted the present action. (R. 20.) The District Court held that the claimed net operating loss deduction was not permissible under Sections 23(s) and 122(b)(2)(C) of the Internal Revenue Code of 1939, and accordingly sustained the Commissioner's disallowance of the deduction. (R. 36-45.) The Court of Appeals affirmed. (Pet. 13-29.)

ARGUMENT

The decision below is correct and is not in direct conflict with any other decisions. Legislative changes in the applicable statute, moreover, have rendered the question presented of diminishing importance.

1. Section 23(s) of the Internal Revenue Code of 1939 (Appendix, *infra*, pp. 12-14) authorizes a "net operating loss deduction computed under section 122." The latter section (Section 122(b) and (c), Appendix, *infra*, pp. 12-14) in turn provides that, "If * * * the taxpayer has a net operating loss" for a designated taxable year, the loss may, with certain adjustments, be carried backward or

forward as a deduction against income earned in other years.

Relying on these provisions, the taxpayer corporation claims the right to carry over and deduct from its income for the taxable year here involved (1950 fiscal year) net operating losses sustained in prior years by three other corporations which, together with thirteen additional corporations, were merged into it. The courts below, sustaining the Commissioner's determination, held that the pre-merger losses of the three merged corporations were not deductible from taxpayer's post-merger income from the new consolidated enterprise. Their decision is plainly in accord with the applicable statutory provisions. Section 122(b)(2)(C) explicitly confines the privilege of carrying over a net operating loss from one year to another to "the taxpayer" who sustained the loss. The losses which taxpayer here seeks to carry over and deduct were not sustained by it. They were sustained by three other corporations which were merged into it and were no longer in existence during the taxable year here involved.

The decision below is also in accord with this Court's decision in *New Colonial Co.* v. *Helvering*, 292 U.S. 435. It was there held that a corporation which acquired the assets and liabilities of another corporation in exchange for its stock pursuant to a reorganization was not entitled to carry over and deduct the predecessor corpora-

tion's loss under a statutory provision similar in all material respects to that here applicable. Notwithstanding that the successor corporation continued to operate the same business and had the same stockholders, it was denied the deduction since the two corporations were not the same "taxpayer" within the purview of the statute. Pointing out (pp. 440-441) that the words of the statute were "plain and free from ambiguity," the Court stated that "they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed."

The instant case presents an *a fortiori* situation for denial of the claimed deduction. Here the taxpayer corporation not only was a different taxpayer from the one which sustained the loss, but—unlike the successor corporation in *New Colonial*—it did not even carry on the same business as that of its predecessor. It acquired the assets of three separate retail stores whose businesses were unprofitable, combined them with those of thirteen other stores whose businesses were profitable, and now seeks to offset against the profits of the new combined enterprise the losses sustained by the three losing ventures. (R. 16-19.) Moreover, each of the three stores whose losses taxpayer now seeks to carry over and deduct from the income of the new enterprise continued to have losses during the taxable year (R. 19), so that in the absence of the merger there would have been

no operating loss deduction. In effect, taxpayer is seeking solely by virtue of the merger to create a right to a net operating loss deduction which would not otherwise have existed.

2. The two cases upon which taxpayer relies for conflict are readily distinguishable, as the court below pointed out. (Pet. 18-21, 25-26.)

In *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573 (C.A. 2d), the first case with which taxpayer asserts conflict (Pet. 5, 6-8), an operating company was merged with a parent holding company, the business carried on after the merger was substantially the same as that theretofore carried on by the operating company, and even without the merger the latter would have been entitled to the claimed carry-over of an unused excess profits credit. Here sixteen separate operating corporations conducting sixteen separate stores were merged into a seventeenth corporation, so that the business thereafter carried on was substantially different, and taxpayer is attempting to deduct pre-merger losses of three of the stores from the post-merger income of the other stores. Moreover, since these three stores continued to operate at a loss after the merger, taxpayer is claiming a tax benefit to which it admittedly would not have been entitled without the merger. The court below accordingly considered the instant case distinguishable from *Stanton* for the reason (Pet. 21) that there the court was dealing

with "essentially a continuing enterprise"—a feature conspicuously absent here.

Nor is there any direct conflict between the decision below and *E. & J. Gallo Winery* v. *Commissioner*, 227 F. 2d 699 (C.A. 9th), the other case upon which taxpayer relies. (Pet. 5, 8-10.) As the court below observed (Pet. 25-26), although the *Gallo* opinion does not disclose "whether or not there was involved a continuing enterprise" in that case,[1] the court in *Gallo* places primary emphasis on the *Stanton* decision. The court below concluded (Pet. 26) that "Apparently the *Gallo* and *Stanton* cases stand on the same footing," thus viewing both those cases as distinguishable from this one for the same reasons. Furthermore, it does not appear from the *Gallo* opinion whether the predecessor corporation in that case would have been entitled to the claimed deduction in the absence of the merger. As pointed out above, had there been no merger in the instant case, the three corporations which sustained the losses in question here would not have been entitled to a deduction based on those losses.

In short, in view of these significant differences between this case and the *Stanton* and *Gallo* cases, the decision below cannot be said to create a real

[1] We note that Government counsel in the *Gallo* case, both in the Tax Court and in the Court of Appeals, did not urge any "continuing enterprise" test as a basis of decision but instead contended that the *Stanton* case should not be followed.

conflict. Indeed, it was on the ground that no direct conflict exists that the Commissioner refrained from applying for certiorari in those cases.[2]

3. While there are a number of cases still pending which involve the general question here presented, the basis for future litigation has been largely removed by virtue of legislative changes in the applicable provisions of the taxing statute.

Insofar as the carry-over or carry-back of an unused excess profits credit is concerned—the issue involved in the *Stanton* and *Gallo* cases—the World War II Excess Profits Tax Act (Subchapter E of Chapter 2 of the Internal Revenue Code

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[2] The decision below was entered before expiration of the time to apply for certiorari in the *Gallo* case, and the Government obtained an extension of time until April 7, 1956, in order to consider the advisability of applying for certiorari in that case in the light of the decision below. After consideration, it was concluded that no petition should be filed because of the absence of a conflict. Nor has a petition been filed by the Government in *Koppers Co.* v. *United States*, 134 F. Supp. 290 (C. Cls.), which presents a similar question and follows *Stanton*. However, the Government has obtained an extension of time for filing a petition in the *Koppers* case until June 29, 1956, because of the possibility that a conflict may be created by the pending case of *Newmarket Manufacturing Co.* v. *United States*, awaiting decision by the First Circuit Court of Appeals. The decision of the District Court in that case is reported at 130 F. Supp. 706 (D. Mass.). Although similar in some respects, the question presented in *Newmarket* is different in that the net operating loss in issue was sustained by the *successor* corporation which seeks to carry-back the loss as an offset to tax liability of its predecessor.

of 1939) was repealed for taxable years beginning after 1945 by Section 122 of the Revenue Act of 1945, c. 453, 59 Stat. 556, while the Korean War Excess Profits Tax Act of 1950 (Subchapter D of Chapter 1) by its terms expired as to taxable years beginning after 1953. And insofar as the carry-over of a net operating loss is concerned—the issue here presented—the problem has likewise lost much of its importance by reason of changes enacted in the Internal Revenue Code of 1954, applicable to taxable years beginning after 1953. Section 381 of the 1954 Code permits a successor corporation in a tax-free reorganization to carry over various tax benefits (including a net operating loss) which would have been available to the predecessor, provided certain enumerated conditions are met; while companion Section 382 places "Special Limitations on Net Operating Loss Carryovers," even where the conditions specified in Section 381 are met. See H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 41-42 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4066-4067).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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May, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * *

(s) [as added by Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 122 [as added by Section 211, Revenue Act of 1939, *supra*]. *Net Operating Loss Deduction.*

(a) [as amended by Section 105, Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Section 215, Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—

(A) *Loss for Taxable Year Beginning Before 1950.*—If for any taxable year be-

ginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year * * *.

* * *

(2) *Net operating loss carry-over.*—

* * *

(C) [as added by Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452] *Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.*—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years * * *.

* * *

(c) [as amended by Sections 105(c)(3)(B) and 153(b) of the Revenue Act of 1942, *supra*, and Section 121(g)(2) of the Revenue Act

of 1950, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credits provided in sections 26(h) and (i));

* * *

(26 U.S.C. 1952 ed., Sec. 122.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939.

Sec. 29.122-1. *Net Operating Loss Deduction*—(*a*) *General.*—Section 122 provides the rules for the computation of the net operating loss deduction allowed by section 23(s). The net operating loss deduction is the aggregate of the net operating loss carry-overs and carry-backs to the taxable year, reduced by certain adjustments to prevent the deduction of losses absorbed by income not taxed.

* * *

(b) [As amended by T. D. 5963, 1953-1 Cum. Bull. 197] *Steps in computation of net operating loss deduction.*—There are three

steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for any preceding or succeeding taxable year from which a net operating loss may be carried forward or carried back to the current taxable year. The second is the computation of the net operating loss carry-overs to the taxable year from such preceding taxable years and the computation of the net operating loss carry-backs to the taxable year from such succeeding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

* * *

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